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Report of Committee on Terminology

FOREWORD

THE MEMBERS of the committee on accounting procedure have read and approved this report of the committee on terminology for presentation to the Council and for publication, but the statements herein contained are not to be regarded as formal pronouncements of the committee on accounting procedure.

At its May meeting the Council of the Institute received the report, and authorized its publication as a research bulletin.

REPORT OF THE COMMITTEE ON TERMINOLOGY

MIDYEAR, 1941

TO THE COUNCIL OF THE
AMERICAN INSTITUTE OF ACCOUNTANTS:

GENTLEMEN:

Definition of "Accounting"

Of the topics discussed in earlier reports of the committee, its definition of the term "accounting"[1] has provoked the most notice. Several suggestions have been received, chiefly to the effect that the definition should be made more explicit by mention of other details of accounting. The committee for the most part agrees with the substance of the suggestions made, but questions the desirability of writing its definitions in terms which, while they may sharpen the presentation, yet may also limit the scope of the term unduly. One suggestion, however, has seemed deserving of consideration, and that is to mention in the definition the interpretative aspect of the accountant's work. The committee's definition might therefore be amended to read:

> Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.

[1] Accounting Research Bulletin No. 7, p. 58.

Other Terms Defined Here

The committee continues its discussion of common accounting terms, with special reference to those terms over which confusion arises because they are so frequently used in a technical as well as a popular sense. There are several groups of related terms which are of great importance to accountants, and the committee here addresses itself to a discussion of them, leading to suggested definitions. These groups of terms are:

(a) Balance sheet—assets—liabilities
(b) Income—income account (or income statement)—profit—profit-and-loss account (or profit-and-loss statement)—undivided profits—earned surplus
(c) Value and its derivatives
(d) Audit and its derivatives
(e) Auditor's report (or certificate)

All of these terms will be recognized as basic to accounting and important to all who prepare or use accounting statements. A more general understanding of the specialized accounting uses of the terms is desirable. As indicated in previous reports (Bulletin No. 7, page 54), it is with these specialized uses only that this committee's reports deal.

(a) Balance Sheet—Assets—Liabilities

The terms "balance sheet," "assets," and "liabilities" are so closely related that the definitions of the three can best be considered together. Indeed, often a balance sheet is first defined as a statement of assets and liabilities (or of assets, liabilities and capital) and the definition of assets and liabilities then undertaken. This procedure, however, overlooks the fact in regard to a balance sheet emphasized in the report of the committee on terminology in 1931, that it is a summary of balances prepared from books of account kept by double-entry methods, while a statement of assets and liabilities may be prepared for an organization for which no such books are kept. The committee deems it advisable to emphasize this distinction in any definition. Moreover, "balance sheet" is a distinctly technical accounting term while "assets" and "liabilities" are less so. The committee feels that "balance sheet" should be defined in terms of its accounting origin and that the relation thereto of assets and liabilities should be considered subsequently.

Considered in this way a balance sheet may be defined as:

> A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of books

> of account kept by double-entry methods, according to the rules or principles[1] of accounting. The items reflected on the two sides of the balance sheet are commonly called assets and liabilities, respectively.

The definition in the *Century Dictionary* is taken from Bouvier's *Law Dictionary* and is worthy of analysis. It reads as follows:

> A statement made by merchants and others to show the true state of a particular business. A balance sheet should exhibit all the balances of debits and credits, also the value of the merchandise, and the result of the whole.

The use of the word "true" in the first sentence is regrettable since it adds nothing to the definition but suggests a possibility of certainty that does not exist. The second sentence recognizes the nature of the balance sheet as a statement of balances. The merchandise clause indicates that the definition originated in a day when the inventory was a figure introduced into the books as a part of the final closing. The word "value" is used in the same loose sense in which it is commonly used in discussing accounts, and particularly inventories. When thus analyzed this definition is found to be in no way inconsistent with the definition set forth above. The term "balance sheet," it may be added, has too often been construed in a mood of wishful thinking to describe what the writer would like a balance sheet to be, without regard to the practicability of his desire.

Accounting analysis frequently requires that two accounts be carried, with balances on opposite sides, in respect to the same thing (e.g., a building account and a building-depreciation account). In the balance sheet the net amount of such balances is usually though not invariably shown. A special case of this kind is presented by a corporation which has a deficit. Preferably such a deficit should be deducted from the credit side of the balance sheet but it is still common to show it on the debit side. This being so, a deficit necessarily appears as an exception in the definition of asset which follows.

Those things which are reflected in the debit balances that are or would be properly carried forward are termed "assets," and those reflected in credit balances, "liabilities." Hence the expression "state-

[1] Cf. Accounting Research Bulletin No. 7, p. 60: "Initially, accounting rules are mere postulates derived from experience and reason. Only after they have proved useful, and become generally accepted, do they become principles of accounting." Thus the word "principle" is used in the sense of: "A general law or rule adopted or professed as a guide to action; a settled ground or basis of conduct or practice . . ." (*New English Dictionary*).

ment of assets and liabilities" is frequently used as synonymous with "balance sheet," though as already pointed out not every statement of assets and liabilities is a balance sheet.

Hence, also, "asset," as used in balance-sheet headings, may be regarded as the name given to anything which is reflected as a debit balance that is or would be properly carried forward upon a closing of books of account kept by double-entry methods. Since such debit balances may represent either property rights acquired, or costs or expenses incurred, the word "asset" is not synonymous with or limited to property but includes also that part of any cost or expense incurred which is properly carried forward upon a closing of books at a given date. The basis of such carrying forward is that the balances represent either (a) property rights or values acquired or (b) expenditures that are either recoverable in or proper charges against the future. A definition of "asset," as used in balance sheets, which is consistent with the proposed definition of "balance sheet" would be:

> A thing represented by a debit balance (other than a deficit) that is or would be properly carried forward upon a closing of books of account kept by double-entry methods, according to the rules or principles of accounting.

In order to make the definition informative, the following addition might be made:

> The presumptive grounds for carrying the balance forward are that it represents either a property right or value acquired, or an expenditure made which has created a property right, or which is properly applicable to the future. Thus, plant, accounts receivable, inventory, and a deferred charge are all assets in balance-sheet classification.

The last named is not an asset in the popular sense, but if it may be carried forward as a proper charge against future income, then in an accounting sense, and particularly in a balance-sheet classification, it is an asset.

Similarly, in relation to a balance sheet, "liability" is:

> A thing represented by a credit balance that is or would be properly carried forward upon a closing of books of account kept by double-entry methods, according to the rules or principles of accounting, provided such credit balance is not in effect a negative balance applicable to an asset. Thus the word is used broadly to comprise not only items which constitute liabilities in the popular sense of debts or obligations (including provision for those that are unascertained), but also credit balances to be

> accounted for which do not involve the debtor and creditor relation. For example, capital stock, deferred credits to income, and surplus are balance-sheet liabilities in that they represent balances to be accounted for by the company; though these are not liabilities in the ordinary sense of debts owed to legal creditors.

In recent times there has been a disposition in uniform accounting systems of regulatory commissions to adopt some such terms as "Assets and other debits" and "Liabilities and other credits" as the titles of the two sides of the balance sheet. When analyzed these terms are scarcely more illuminating than the headings "Debits" and "Credits" unless a clear distinction is drawn between the items that are assets and those that are other debits, with a similar distinction on the liabilities side. This is not done or at least not accurately done in such classifications.

(b) *Income—Income Account (or Income Statement)—Profit—Profit-and-loss Account (or Profit-and-Loss Statement)—Undistributed Profits—Earned Surplus*

It is sometimes urged in criticism of the law that it has failed to classify adequately the entities with which it deals, and even has extended some classifications to cover entities not actually falling within them. The same charge can fairly be made against the accounting use of the terms "earnings," "income," "profits," and their derivatives. "Profit" and "profit-and-loss account" (or "statement") are older, more inclusive, and more informative expressions to be applied to industrial and mercantile enterprises and their results than "income" and "income account" (or "statement").

The New English Dictionary cites a reference to the "famous accompt of profit and loss" of 1588, and defines the account as "an account in book-keeping to which all gains are credited and losses are debited, so as to strike a balance between them, and ascertain the net gain or loss at any time." It does not mention the income account and defines "income" as the periodical produce of one's work, business, lands or investments, with the earliest citation from a work published in 1601.

There was clearly an opportunity for distinctive uses of the terms "earnings," "income," "profits," and of the corresponding accounts or "statements." The terminology committee of 1931 set forth certain usages which it believed were then "well established" as follows:

> Earnings applies to the operations of a concern rendering service, as distinguished from one selling commodities.
>
> Profits applies to manufacturing and mercantile concerns.

> Income, while sometimes used by corporations, frequently as applied to net earnings, applies more particularly to the compensation or profits received by a person.

No doubt the income tax is largely responsible for the extension of the use of the term "income" into the industrial field and of the use of the expression "income account" (or "statement"), one result of which has been to reduce the term "profit-and-loss account" to a state of ill defined subserviency to the term "income account."

The Supreme Court has defined "income" in a case in which the meaning of the word as used in a constitutional amendment was the question at issue. The Court said that it must be construed in its generally understood sense rather than as a technical term. The Court's definition conformed closely to the accounting concept, and is, therefore, appropriate for adoption by accountants for general use as well as for tax purposes. The Court accepted the language of an earlier decision, with an added proviso, so that its definition read:

> Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets . . . (*Eisner* v. *Macomber;* 252 U. S. 189).

Income is also used in a narrower sense to mean the share of a gain that accrues to a particular person or group of persons, natural or legal. The income of an enterprise may be divisible among many interests in a certain order of priority. The portion which remains after deducting prior charges is the net income from the standpoint of the interest or interests then remaining. As used in corporation accounting, therefore, net income means the portion of gross income remaining after deducting all claims (such as bond interest) ranking ahead of that of the corporation as a legal person.

The distinction between negative elements in determining income and claims against income is, like all accounting distinctions, difficult to draw precisely. For instance, in the case of an industrial company there are items such as "cost of goods sold" which are clearly negative elements in determining income. There are others, such as "interest paid" by an industrial company, which are clearly claims against the income derived from operation of a business. General and administrative expenses may be regarded as occupying an intermediate position. Therefore, while "gross" strictly speaking means no more than whole, the term "gross income" may conveniently and is generally used to indicate the balance remaining after deducting from sales or revenue those costs so closely associated with the production thereof as to be generally recognized as negative elements in the computation of income. "Net income" is used to indicate the balance remaining after deducting from gross income all negative elements not theretofore deducted and also claims against income ranking ahead of that of the person, natural or legal, with respect to whom the term is used. From this standpoint a statement of income might properly take the following form:

Sales	— —
Less cost of sales	— —
Gross income	— —
Deduct expenses	— —
Net income from sales	— —
Deduct bond interest	— —
Net income of corporation	— —
Preferred dividends	— —
Net income for common stock	— —

This form is purposely simplified to emphasize the point here at issue. Such questions as showing taxes separately and the questions raised in Bulletin No. 8 are not here considered.

The "income account" (or "statement") is:

> An account or statement which shows the principal elements, positive and negative, in the derivation of income or loss, the claims against income, and the resulting net income or loss of the accounting unit.

In the interests of an accurate and expressive terminology the committee would like to feel itself in a position to recommend the restoration of the words "profit," "profit-and-loss account" (or "statement"), and "undistributed profits," in place of "income," "income account" (or "statement"), and "earned surplus." But it recognizes that the latter terms have become the more general usage, at least among the larger companies, and that the powerful influence of the income-tax authorities, of the regulatory commissions, and other bodies tends to confirm this usage.

The difficulty with "income" as against "profit and loss" is that there is no handy term to express the negative forms of income, in the same way that "loss" does in "profit and loss." The natural antonyms of "income" are either "capital" or "expense"; the former term of course is outside the present discussion, and the latter has acquired a narrower significance than "loss" possesses in the expression "profit and loss." It is important that the accounting profession, in all its educational work, keep the composite nature of "income" (i.e., gain), as the resultant of positive and negative elements, in the forefront of any discussion of the subject.

The difficulty of expressing an unqualified preference for one set of terms rather than the other is illustrated by the following tabulation of practices in 500 reports for 1939:

Income-statement headings:

Titles including "Income"	309
" " "Profit and Loss"	186
Other titles	18
	513*

* Thirteen captions included both "income" and "profit and loss."

Caption for final balance in income statement:

Net income (or phrases including "income")	240
Net profit (" " " "profit")	188
Net loss and variations	27
Other	47
	502*

* One caption included both "income" and "profit"; and one included "profit" and "loss."

The considerable use of both "income" and "profit and loss," and variations thereof, makes it inexpedient at this time to make a definite recommendation that would exclude either use. The committee therefore offers this discussion of the elements involved as a step toward a better understanding, which alone can furnish the basis for greater uniformity of practice. It will be understood that where the term "profit-and-loss statement" is used as synonymous with "income statement" the comments on the income statement herein contained become generally applicable to it.

Formerly the cumulative balance of profit and loss after deduction of dividends was called "undivided profits." Today the corresponding balance is more commonly called "earned surplus." The change has brought no increase of accuracy or lucidity but rather the reverse. The word "earned" does not seem to have been derived from the concept of income as earnings rather than profits, but to have been introduced to distinguish undistributed profits from capital surplus. It is difficult to see why the word "surplus" was used at all, except possibly as a survival of a single-entry concept. If "income" was to be substituted for "profit" it should have sufficed to substitute "undistributed income" for "undistributed profits." The introduction of the challenging and often unwarranted word "earned" seems to be wholly regrettable.

However, the term "earned surplus" gained currency and was used not only in accounting but in legal discussions and statutes. As early as 1927 the Institute apparently accepted it and appointed a special committee whose task was merely to define the expression, not to consider alternatives. That committee, after an extensive inquiry and an issue of questionnaires to the entire membership recommended the following definition:

> Earned surplus is the balance of net profits, income and gains of a corporation from the date of incorporation (or from the date of recapitalization when a deficit was absorbed by a reduction of the par or stated value of the capital stock) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus.

This committee sees no reason to change the substance of the definition so framed except to modify slightly the parenthetical clause so that the definition would read:

> Earned surplus is the balance of net profits, income, and gains of a corporation from the date of incorporation (or from the date when a deficit was absorbed by a charge against the capital surplus created by a reduction of the par or stated value of the capital stock or otherwise) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus.

(c) *Value and Its Derivatives*

Mr. Justice Brandeis has said and Professor Bonbright, in *Valuation of Property*, has proved that "value" is a word of many meanings. In the first place, just as beauty lies in the eye of the beholder, so worth lies in the mind of the appraiser. There is often no unique standard of worth which is both realistic and objective. The fact that there are different criteria of worth is strikingly illustrated in the Supreme Court decisions which have applied different methods of determining value in connection with the regulation, taxation, and reorganization of railroads, respectively. But apart from the difficulty of measuring "value" when the word is used to connote "worth," it is evident that in the literature of business, economics, and accounting, "value" is used in varying significances, not all of which have any definite connotation of worth. The word should, therefore, seldom if ever be used by accountants without a qualifying adjective. The word is, in fact, commonly employed in accounting to describe the figure at which an asset or liability is carried, even though the amount may be determined by a process which is not one of valuation in any ordinary sense.

Since accounting is predominantly based upon cost, the proper uses of the word "value" in accounting are largely restricted to the statement of items at cost, or at modifications of cost. In accounting the term "market value" is used in senses differing somewhat from those attaching to the expression in law. As applied to securities it means a sum computed on the assumption that value is measurable by market quotations; as applied to inventories it is a constructive market value compiled from a variety of considerations, including market quotations, cost of replacement, and probable sales price. In the case of so-called fixed assets the value shown in accounts is the balance of their cost after deducting recorded depreciation. Thus the following definition would seem to be appropriate:

> "Value" as used in accounts signifies the amount at which an item is stated, in accordance with the accounting rules or principles relating to that item. Generally book or balance-sheet values (using the word "value" in this sense) represent cost to the accounting unit or some modification thereof; but sometimes they are determined in other ways, as for instance on the basis of market values or cost of replacement, in which cases the basis should be indicated in financial statements.

In thus emphasizing the fact that accounting values are predominantly costs, the committee would like to make clear its view that costs are in general much more real and much more significant to those who use accounts, than values in the general meaning of that word. The recognition by the Supreme Court in recent decisions of the crucial importance of expectations for the always uncertain future as a factor in the determination of value confirms the wisdom of the complete rejection in accounting of the "worth" basis for the statement of assets not intended to be sold within any foreseeable future, such as fixed assets.

(d) *Audit and Its Derivatives*

It is generally known that the origin of the word "audit" relates it to "hearing," and traces of this early usage, signifying the hearing by proper authorities of accounts rendered by word of mouth, still linger in such phrases as "hearing witnesses"[1] and "examine witnesses,"[2] included in definitions of "audit." From this to the modern applications of the word is, however, a considerable distance. Perhaps the modern practice nearest to the original sense is reflected in the term "audited vouchers," meaning documents examined in the process of establishing the authenticity of payments made or to be made.

From this point the use of the term "audit" has been extended to include the examination of any records to ascertain whether they correctly record the facts purported to be recorded. The next step extended the usage to statements prepared as summaries of records, so that an "audit" was concerned not only with the truth of the records, but also with the question whether or not the statements were faithfully prepared from those records.

But the most notable development in the use of the term is that which has to do with the preparation of statements "in conformity with generally accepted accounting principles," signifying that the auditor is no longer exclusively concerned with the technical accuracy of the records, but is also interested in the principles or rules which have governed the accounting allocations entering into the results shown in the statements. Among the earliest official recognitions of this form of audit was that included in the *Federal Reserve Bulletin* for April, 1917:[3] "any plan for immediate adoption intended to produce practical results must recognize that under present practice probably more than 90 per cent of the statements certified by public accountants are what are called balance-sheet audits." The form of certificate suggested in this bulletin states that the statements "have been made in accordance with the plan suggested and advised by the Federal Reserve Board." The plan referred to had been formulated by a committee of this Institute. Not only is this therefore the first official use of the term "balance-sheet audit," it is also the first official recognition of the desirability of a generally accepted and publicly stated set of general rules to serve as criteria for judging the accounting and auditing practices underlying the statements. The role assumed by the Federal Reserve Board has now devolved upon the Securities and Exchange Commission, in consultation with which the committee on auditing procedure of the American Institute of Accountants has evolved the present standardized form of certificate or auditor's report.

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[1] *New Standard Dictionary.*
[2] *The Century Dictionary.*
[3] "Approved Methods for the Preparation of Balance Sheet Statements: A Tentative Proposal Submitted by the Federal Reserve Board."

The auditing requirements implied in the issuing of this form of report have become so generally recognized that the term "audit," used without qualification in relation to the accounts of a corporation, is generally interpreted to indicate that these requirements have been met. Any examination, therefore, which is less in scope than these requirements should not be called an audit without qualifications, but should be described in adequate definitive terms.

It thus becomes clear that the end result of the audit is in many cases the expression of an opinion by the auditor to the effect that the statements are what they purport to be. But such general terms as that could not satisfy the requirements of the situation, since they would leave it open to the reader to supply his own standards or definitions of what the statements are intended to mean. Hence the reference, in the earlier publication, to "the plan suggested and advised by the Federal Reserve Board," and in Bulletin No. 5 of the committee on auditing procedure, to "conformity with generally accepted accounting principles." Only in the light of these principles is it proper to interpret and judge the statements.

The word "opinion" is also important. In the circumstances described it is not possible for the auditor to state as a literal fact that the statements are true, or that they have been prepared "in conformity with generally accepted accounting principles." All that the circumstances warrant is an expression of opinion; and although it is true that the auditor is presumed to have qualified himself to express an opinion, both by his general training and by his examination of the particular case, yet his report is a statement of opinion, not of fact.

Another essential characteristic of an audit of records is that it shall be performed "by one who has no part in their preparation."[1] The same idea is expressed in the S.E.C. requirement that "The financial statements required shall be accompanied by a certificate of an *independent* public or *independent* certified public accountant or accountants."[2] Clearly the opinion contained in the auditor's report can have little value unless it is entirely free from any interest which may have affected the original accounting.

These considerations, and an examination of the report of the committee on terminology of 1938 which studied the question carefully, suggest definitions of "audit" as follows:

> In general, an examination of an accounting document and of supporting evidence for the purpose of reaching an informed

[1] "Auditing," by R. H. Montgomery, in *Encyclopaedia of Social Sciences.*
[2] Instructions for Form A-2.

opinion concerning its propriety. Specifically:

(1) An examination of a claim for payment or credit and of supporting evidence for the purpose of determining whether the expenditure is properly authorized, has been or should be duly made, and how it should be treated in the accounts of the payor —hence "audited voucher."

(2) An examination of similar character and purpose of an account purporting to deal with actual transactions only, such as receipts and payments.

(3) By extension, an examination of accounts which purport to reflect not only actual transactions but valuations, estimates, and opinions, for the purpose of determining whether the accounts are properly stated and fairly reflect the matters with which they purport to deal.

(4) An examination intended to serve as a basis for an expression of opinion regarding the fairness, consistency, and conformity with accepted accounting principles, of statements prepared by a corporation or other entity for publication—in this sense more generally called "examination" (See S.E.C. Regulation S-X and Statement on Auditing Procedure No. 5, page 41).

(e) *Auditor's Report* (*or Certificate*)

In the foregoing discussion the auditor's statement about the accounts has been called both a "certificate" and a "report." The former has at times been the more common term, but the two terms were long ago regarded as interchangeable.

In Great Britain the Companies Act (1845) required the auditors to "make a special report"; but the Waterworks Act (1847), the Railway Companies Act (1867) and the Metropolis Water Act (1871) all use the terms "certified," "certificate," or "certify." The early volumes of *The Accountant* (London), dated in the 1880's, have a number of articles entitled "Accountant's Certificates," in the body of which the document is frequently referred to as "the report." The Companies Act of 1929 (a consolidating statute) uses the term "report."

In the United States the *Federal Reserve Bulletin* (1917) spoke of the "Form of Certificate." The report of the special committee on accounting procedure, dated October 14, 1932, said: "The expression 'auditor's certificate' is still frequently used, describing the short report and opinion of the accountant . . ." It was therefore natural that the Securities Act of 1933 should repeatedly speak of statements "certified" by accountants, and that this usage should be followed in the regulations of the Securities and Exchange Commission. Before this date, however, question had been raised as to the propriety and usefulness of the words "to certify" and "certificate"; it was pointed out that they were misleading to the extent that they conveyed to ordinary readers an impression of greater certainty or accuracy than accounts could possess, or that they represented that the auditor was expressing more than his opinion about the accounts. In a letter dated December 21, 1933, the special committee on coöperation with stock exchanges wrote: "To this end, we think it desirable that the document signed by the accountants should be in the form of a report, as in England, rather than a certificate, and that the words 'in our (my) opinion' should always be embodied therein." But one of the notes to the form recommended with that letter spoke of the "certificate," and other committees have frequently found themselves obliged to use "report" and "certificate" interchangeably, as in the recent correspondence between the committee on auditing procedure and the Securities and Exchange Commission.[1] In these circumstances the continued use of both terms can scarcely be avoided, and the important thing is to emphasize the fact that the choice of one term or the other implies no difference of scope or purport, and to make that purport clear. This might be done by the following definition:

> Report (or certificate) of an independent accountant (or auditor) is a document in which he indicates briefly the nature and scope of the examination (audit) which he has made and expresses the opinion which he has formed in respect of the financial statements.

The word "report" as synonymous with "certificate" (sometimes also called "short form of report") is used primarily in connection with audits of the kind covered by the fourth definition above given. In relation to other kinds of audits the report may take varying forms according to the nature and scope of the work undertaken.

Summary

In the section which follows, the several definitions of specialized accounting uses of terms suggested in this or previous reports are brought together, and there are given also the dictionary definitions which come closest to them of any that the research department has discovered. The latter are included for comparison only, and are not necessarily approved. In some cases they are obviously defective. It should be clearly understood that the committee's definitions are

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[1] Statements on Auditing Procedure—No. 5.

to be read in connection with the discussion which preceded them and are not comprehensive, nor exclusive of other uses.

COMMITTEE DEFINITIONS	DICTIONARY DEFINITIONS
Accounting:	
The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.	The art or system of making up or stating accounts; the body of scientific principles underlying the keeping and explanation of business accounts. (Webster [1])
Audit:	
In general, an examination of an accounting document and of supporting evidence for the purpose of reaching an informed opinion concerning its propriety. Specifically:	A formal or official examination and verification of accounts, vouchers, and other records. (Webster [1])
(1) An examination of a claim for payment or credit and of supporting evidence for the purpose of determining whether the expenditure is properly authorized, has been or should be duly made, and how it should be treated in the accounts of the payor—hence "audited voucher."	
(2) An examination of similar character and purpose of an account purporting to deal with actual transactions only, such as receipts and payments.	
(3) By extension, an examination of accounts which purport to reflect not only actual transactions but valuations, estimates and opinions, for the purpose of determining whether the accounts are properly stated and fairly reflect the matters with which they purport to deal.	

[1] Webster's *New International Dictionary* (1940).

COMMITTEE DEFINITIONS (continued)	DICTIONARY DEFINITIONS (continued)
(4) An examination intended to serve as a basis for an expression of opinion regarding the fairness, consistency and conformity with accepted accounting principles, of statements prepared by a corporation or other entity for publication—in this sense more generally called "examination" (See S.E.C. Regulation S-X and Statement on Auditing Procedure No. 5, page 41).	
Auditor's Report (*or Certificate*): A document in which an independent accountant (or auditor) indicates briefly the nature and scope of the examination (audit) which he has made and expresses the opinion which he has formed in respect of the financial statements.	The certificate issued by an auditor as to the accuracy of accounts. (Webster [1])
Balance Sheet: A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of books of account kept by double-entry methods, according to the rules or principles of accounting. The items reflected on the two sides of the balance sheet are commonly called assets and liabilities, respectively.	A statement made by merchants and others to show the true state of a particular business. A balance sheet should exhibit all the balances of debits and credits, also the value of merchandise, and the result of the whole. (Bouvier [2])
Asset (as a balance-sheet heading): A thing represented by a debit balance (other than a deficit) that is or would be properly carried forward upon a closing	The Dr. and Cr. sides of a Balance Account contain "Assets" and "Liabilities" respectively. (In this sense always used as *plural*,

[1] Webster's *New International Dictionary* (1940).

[2] Bouvier's *Law Dictionary* (1934).

COMMITTEE DEFINITIONS (continued)

of books of account kept by double-entry methods, according to the rules or principles of accounting. The presumptive grounds for carrying the balance forward are that it represents either a property right or value acquired, or an expenditure made which has created a property right, or which is properly applicable to the future. Thus, plant, accounts receivable, inventory and a deferred charge are all assets in balance-sheet classification.

Liability (as a balance-sheet heading):

A thing represented by a credit balance that is or would be properly carried forward upon a closing of books of account kept by double-entry methods, according to the rules or principles of accounting, provided such credit balance is not in effect a negative balance applicable to an asset. Thus the word is used broadly to comprise not only items which constitute liabilities in the popular sense of debts or obligations (including provision for those that are unascertained), but also credit balances to be accounted for which do not involve the debtor and creditor relation. For example, capital stock, deferred credits to income and surplus are balance-sheet liabilities in that they represent balances to

DICTIONARY DEFINITIONS (continued)

with singular *asset* applied to a single item appearing on the debit side.) (*The New English Dictionary* [1])

The series of items on the balance sheet of a business enterprise, showing the book value of its resources at any given date. (Webster [2])

That which one is under obligation to pay, or for which one is liable. Specif. in the *pl.* one's pecuniary obligations, or debts, collectively:—opposed to *assets.* (Webster [2])

[1] *The New English Dictionary on Historical Principles* (1888–1928).
[2] Webster's *New International Dictionary* (1940).

COMMITTEE DEFINITIONS (continued)

be accounted for by the company; though these are not liabilities in the ordinary sense of debts owed to legal creditors.

DICTIONARY DEFINITIONS (continued)

Earned Surplus:

The balance of net profits, income and gains of a corporation from the date of incorporation (or from the date when a deficit was absorbed by a charge against the capital surplus created by a reduction of the par or stated value of the capital stock or otherwise) after deducting losses and after deducting distributions to stockholders and transfers to capital-stock accounts when made out of such surplus.

The balance of profits and income of a concern remaining after deducting losses, dividends, and transfers to capital stock accounts. (Webster—accounting definition. [1])

Income:

The gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets . . . (*Eisner* v. *Macomber;* 252 U. S. 189)

That gain or recurrent benefit (usually measured in money) which proceeds from labor, business, or property; commercial revenue or receipts of any kind. (Webster [1])

Income Account (*or Income Statement*)*:*

An account or statement which shows the principal elements, positive and negative, in the derivation of income or loss, the claims against income, and the resulting net income or loss of the accounting unit.

In corporation finance, the account that states the amount, sources and expenditure of income.
(Webster [1] — accounting definition.)

Principle (of accounting):

1. Initially, a postulate derived from experience and reason.
2. More especially, such postu-

A general law or rule adopted or professed as a guide to action; a settled ground or basis of con-

[1] Webster's *New International Dictionary* (1940).

COMMITTEE DEFINITIONS (continued)	DICTIONARY DEFINITIONS (continued)
lates as have proved useful and have become generally accepted.	duct or practice. (*The New English Dictionary*[1])
Public Accounting: The practice of this art (accounting) by men whose services are available to the public for compensation. It may consist in the performance of original work, in the examination and revision of the original work of others (auditing) or in rendering of collateral services for which a knowledge of the art and experience in its practice create a special fitness.	An accountant whose services are available to the public. (Webster[2]—definition for "public accoun*tant*.")
Value: As used in accounts signifies the amount at which an item is stated, in accordance with the accounting rules or principles relating to that item. Generally book or balance-sheet values (using the word "value" in this sense) represent cost to the accounting unit or some modification thereof; but sometimes they are determined in other ways, as for instance on the basis of market values or cost of replacement, in which cases the basis should be indicated in financial statements.	No definition has been found in the general dictionaries which corresponds to the accounting definition—but note use of "book value" in Webster's definition of assets.

Respectfully submitted,

GEORGE O. MAY, *Chairman*
GEORGE D. BAILEY
WILLIAM D. CRANSTOUN

May 13, 1941.

[1] *The New English Dictionary on Historical Principles* (1888–1928).
[2] Webster's *New International Dictionary* (1940).